No. 14995

In the United States Court of Appeals for the Ninth Circuit

MASAO HIRASUNA, Doing Business as Mike's Auto Top Shop & Upholstery Shop, APPELLANT

v.

S. V. MCKENNEY, District Director of Internal Revenue, APPELLEE

ON APPEAL FROM THE JUDGMENT OF THE UNITED STATES DISTRICT COURT FOR THE DISTRICT OF HAWAII

BRIEF FOR THE APPELLEE

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OPINION BELOW

The opinion of the District Court (R. 50-60) is reported at 135 F. Supp. 897.

JURISDICTION

This appeal involves a suit by a resident and citizen of Hawaii for refund of manufacturer's excise taxes imposed under Section 3403 of the Internal Revenue Code of 1939, claimed to have been illegally collected to the extent of $1,391.92 by the Director on May 30, 1953, who was then the District Director of Internal Revenue for Hawaii. (R. 3-17, 48.) Claims for refund were filed on October 27, 1954. (R. 5-6, 50.)

Taxpayer did not receive by registered mail any formal notice of allowance or disallowance of the refund claims within the time prescribed in Section 6532 of the Internal Revenue Code of 1954, and on May 2, 1955 (R. 17), being more than six months after the filing of the refund claims, taxpayer brought the instant suit in the United States District Court for the District of Hawaii (R. 3-17). Jurisdiction of the District Court exists by virtue of 28 U.S.C., Section 1340. Judgment was entered in favor of the District Director on December 8, 1955. (R. 60-61.) Notice of appeal to this Court was timely filed on December 21, 1955, by taxpayer within sixty days. (R. 62.) Jurisdiction of this Court to hear and determine this appeal is conferred by 28 U.S.C., Section 1291.

QUESTIONS PRESENTED

1. Whether the District Court erred in holding that taxpayer was a "manufacturer" of automobile seat covers within the meaning of that word in Section 3403 of the Internal Revenue Code of 1939.

2. Whether the District Court erred in holding that taxpayer's sales of automobile seat covers were sales of automobile "parts or accessories" within the meaning of those words in Section 3403 of the Internal Revenue Code of 1939.

STATUTE AND OTHER AUTHORITIES INVOLVED

The pertinent provisions of the statute and other authorities involved are set forth in the Appendix, *infra*.

STATEMENT

This suit was brought in the District Court for the District of Hawaii for refund of manufacturers' excise taxes assessed against and paid by taxpayer in the

amounts of $348.78 for 1949, $410.24 for 1950, $491.63 for 1951, and $516.05 for 1952, totaling $1,766.70, plus interest. (R. 4, 6.) The parties stipulated as follows:

Taxpayer at all times has been a resident and citizen of the Territory of Hawaii. (R. 43-44.) Appellee is a resident and citizen of Hawaii and was during the years 1953, 1954 and until September 1, 1955, the sole District Director of Internal Revenue for the District of Hawaii and was fully authorized to collect taxes due the United States from all taxpayers in Hawaii, especially taxes due under Section 3403 of the Internal Revenue Code of 1939. (R. 49-50.) At all times material taxpayer operated a business under the style of "Mike's Auto Top and Upholstery Shop" in Honolulu. During the early part of 1953 the District Director through his agents made assessment against taxpayer in the total amount of $1,766.70 for taxes claimed to be due from taxpayer as a manufacturer within the meaning of Section 3403 of the Internal Revenue Code of 1939,[1] as set forth in detail in the schedules forming part of the stipulation. (R. 44-47.)

It was also stipulated that $374.78 was properly assessed, leaving the amount of $1,391.92 of the taxes collected in dispute (R. 48) and that this latter amount consists of sums assessed against sales to used-car dealers of custom-made seat covers only (R. 48, 51). The parties further agreed that the amount of $1,391.92 is the proper assessment for the period in question if the custom-made automobile seat covers are automobile accessories and manufactured or produced as contemplated by Section 3403 of the Internal Revenue Code. (R. 48, 51.)

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[1] References below to Code or Internal Revenue Code, unless otherwise noted, are to the Internal Revenue Code of 1939.

Taxpayer fully paid the assessment in the amount of $1,766.70 to the District Director on May 30, 1953. (R. 48.) On October 27, 1954, taxpayer regularly filed with the District Director four claims for refund for each of the periods above mentioned. (R. 50.)

Trial was held by the court without a jury (R. 51) and evidence, both oral and documentary, was introduced. (R. 61, 65-130). The District Court made the following findings of fact:

During the period from January 1, 1949, to August 31, 1952, taxpayer was engaged in the business of covering automobile seats. The materials used were kept in stock in roll form, at taxpayer's place of business, in large quantities and various types, quality and colors. Customers desiring their car seats covered brought their cars to taxpayer's place of business and after selecting the type, quality and color of materials to be used left their cars. The customers designated the seats or parts of them to be covered. Taxpayer took measurements, cut and sewed the material and installed it by tacking it to the car seat. (R. 51-52.)

Further undisputed details with respect to taxpayer's operations appear from the testimony given at the trial as follows:

Taxpayer started in 1935 as a mechanic and has from that time worked in garages on automobiles. (R. 124.) During the tax years in question he was the sole proprietor of "Mike's Auto Top and Upholstery Shop" in Honolulu. (R. 87-88.) His shop was located in a building at the rear of a used-car lot (R. 88) where he was engaged in the business of covering the seats, tops and inside upholstery of automobiles (R. 92-93). This case is concerned only with the nature of his operations

in covering automobile seats. As to this phase of his business, 99 per cent of his orders came from used-car dealers. (R. 93.) And, as already noted, it is stipulated that this case is concerned only with the sales to used-car dealers. (R. 48, 51.) His shop was located in a used-car lot area and he had a working relationship with several dealers whereby they would phone him when they had two or three cars for him to work on, describing the pattern of seat cover and type of material to be used on each. (R. 93, 117-118.) He would then pick up the car, bring it to his shop for the fitting, and return it to the dealer when the job was completed. (R. 94.)

So as to be able to fill any order, taxpayer kept an inventory of bolts or rolls of material of various patterns and colors. (R. 89.) The portion of the seat which forms the back-rest is called the "lazyback", and the portion on which one sits is called the "cushion". (R. 94.) The way in which taxpayer covered the cushions and lazybacks was essentially as follows:

The front cushion was removed from the car and measured. The cloth or covering was then measured roughly to the cushion top dimensions, and cut. It was then laid on the cushion, pulled tight, and pinned temporarily so that a chalk mark could be made around the edge where it was to be sewed. Another piece of cloth called the facing was cut with the scissors, the wrinkles removed, and then sewed to the under side of the covering by machine. Other portions of the cushion were fitted out similarly, and the various pieces of material were then sewn together and piping sewn at all seams. At this point the material had been expertly cut and sewn so as to fit a particular cushion, and would not be usable except on the cushion intended.

(R. 94-96, 111, 119-121.) If the seat had a non-factory seat cover, it was removed. (R. 96.) Factory seat covers were never removed because otherwise the cotton would become separated from the frame making it very difficult to install the new cover. (R. 114.) The cushion was then vacuumed, padded with wadding if necessary (R. 95), and the new cover pulled on and attached with tacks or hog rings (R. 96, 120-121).

The rear cushion and the lazybacks were covered in the same manner except that an additional operation was generally performed on the lazybacks. A border of plastic or woven plastic was sewn along the top as a trim. This border was cut and fitted in the same way as the cover and facing. (R. 98, 120.)

In those cars which had a movable arm rest in the center of the rear lazyback the procedure was different in that the back had to be taken out and three separate covers cut and sewn together. (R. 100, 103.)

In the course of covering the seats taxpayer replaced broken springs with new ones (R. 95), and did any necessary welding (R. 104). Extra charges were assessed the customer for such items. (R. 104.) Taxpayer usually repaired rips in the factory seat covers (R. 114), but without charge because the dealers gave him so much business (R. 110). The price for the seat covers included only the labor and material used in making and installing them. (R. 109, 122-123.)

Working with his one employee, taxpayer could turn out two to five cars a day depending upon the pattern, trim work and type of material used. (R. 89, 109.) The customer would select the pattern and design (R. 101), and the price would depend upon the material used (R. 104). Approximately two-thirds of the cost of any job was the cost of material, the remaining one-

third comprising the labor expended in taking the seats out, measuring, cutting, and sewing the material, fitting the finished cover to the seats, and affixing the seats in the car again. (R. 122-123.) In arriving at the assessment the Commissioner allowed as a deduction from the sales price an amount representing the labor cost attributable to installation. (R. 26, 45-47.)

In any event, as already noted, it is stipulated that the amount of $1,391.92 is the proper assessment if the custom-made automobile seat covers are automobile accessories and manufactured or produced as contemplated by Section 3403 of the Code. (R. 48, 51.)

For reasons stated in its opinion (R. 52-60), the District Court decided this issue in the affirmative.[2]

SUMMARY OF ARGUMENT

The automobile seat covers were properly taxed as automobile parts or accessories sold by the manufacturer within the meaning of Section 3403 of the Internal Revenue Code of 1939. Clearly they were parts or accessories within the meaning of long-standing Treasury Regulations which have been upheld by the Supreme Court. The improved seats are component parts of an automobile; they were designed to be attached or used in connection with the automobile to add to its utility or ornamentation and they are articles the primary use of which is in connection with the automobile, whether or not essential to its operation or use. Moreover, that the seat covers fall within any

[2] Prior to the trial below the District Court had granted summary judgment in favor of the District Director (R. 35-36) but on taxpayer's motion vacated the order of summary judgment (R. 42-43) and set the case down for trial. However, after hearing the witnesses the court again concluded that the District Director was entitled to judgment. (R. 131.)

one of these categories is sufficient. Besides, these articles reached the stage of manufacture in which they were commonly or commercially known as parts or accessories. Although the clause of the Regulations making this provision is not to be read as restricting the other categories, the seat covers in any event fully comply with its terms.

Again there can be little question that the process employed by taxpayer, whereby seat covers were produced in his shop by the application of machinery and skilled labor to raw materials supplied by him, was manufacturing and that the final result was a manufactured article. The used-car dealers who were here the purchasers were not the manufacturers. On the contrary, taxpayer supplied everything — material, labor and the finished article. Title to the material was undoubtedly taxpayer's until the seat cover was completed by him. To assert that taxpayer was merely a repair man is to fly into the face of the undisputed facts.

Plainly these articles manufactured by taxpayer from goods to which he alone had title were sold to his customers, the used-car dealers, when he passed title to the completed seat covers. No more is required to satisfy the terms of Section 3403 and to make the transaction taxable. Provisions of the Internal Revenue Code are here in question; technical distinctions between contracts for work, labor, and materials and contracts to sell, or sales within the purview of the provisions of the Uniform Sales Act are entirely irrelevant. The transaction here falls completely within the meaning of Section 3403 of the Internal Revenue Code and that is all that is required for imposition of the tax.

The administrative position with respect to taxability of sales of automobile seat covers to dealers has at all times been consistent; such sales have at all times been ruled taxable. Even though for a period the Internal Revenue Bureau had issued rulings that the tax did not apply when the seat covers were individually designed by the manufacturer for an automobile belonging to the consumer of the seat covers (and not for resale), this cannot affect the instant situation where sales to dealers are involved and which have always been held taxable. Moreover, sales of seat covers to consumers are now also held taxable and the prior rulings in those cases are no longer followed. Taxpayer shows no reliance on any such rulings nor plainly could he. In any event the Commissioner is not precluded from changing his rulings and is not bound by his own or his predecessors' prior mistakes of law.

ARGUMENT

The Automobile Seat Covers Were Properly Taxed as Automobile Parts or Accessories Sold by the Manufacturer or Producer Within the Meaning of Section 3403 of the Internal Revenue Code of 1939

A. *Introduction*

Section 3403 of the Internal Revenue Code of 1939 (Appendix, *infra*) provides as follows:

> SEC. 3403. TAX ON AUTOMOBILES, ETC.
>
> There shall be imposed upon the following articles sold by the manufacturer, producer, or importer, a tax * * *:
>
> (a) Automobile truck chassis, automobile truck bodies, automobile bus chassis, automobile bus

bodies, truck and bus trailer and semitrailer chassis, truck and bus trailer and semitrailer bodies, tractors of the kind chiefly used for highway transportation in combination with a trailer or semitrailer (including in each of the above cases parts or accessories therefor sold on or in connection therewith or with the sale thereof) * * *

(b) *Other Chassis and Bodies, Etc.*—Other automobile chassis and bodies, chassis and bodies for trailers and semi-trailers (other than house trailers) suitable for use in connection with passenger automobiles, and motorcycles (including in each case parts or accessories therefor sold on or in connection therewith or with the sale thereof), except tractors * * *.

(c) Parts or accessories (other than tires and inner tubes and other than radio and television receiving sets) for any of the articles enumerated in subsection (a) or (b) * * *.

* * * * *

The taxpayer claims his operations during the tax years were not taxable under Section 3403 for four reasons:[3]

(1) He contends that the seat covers he made were not "parts or accessories" within the meaning of subsection (c) as defined by Treasury Regulations 46, Section 316.55 (Appendix, *infra*).

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[3] Section 3403, as quoted above, incorporates amendments effective on and after November 1, 1951, none of which, however, are material to the issues here involved. See Appendix, *infra*. For purposes of this appeal the language of the section may be regarded as substantially the same during the entire period in question.

(2) He contends further that he was not a "manufacturer" or "producer" of seat covers within the meaning of those words in Section 3403 as defined by the courts and Regulations 46, Section 316.4 (Appendix, *infra*).

(3) He contends that there were no contracts of sale made by him.

(4) He claims that the assessments contravene the rulings of the Bureau of Internal Revenue in effect during the tax years.

We shall discuss each of these contentions.

B. *Parts or accessories*

Regulations 46, Section 316.55, define "parts or accessories" as follows:

> SEC. 316.55 *Definition of parts or accessories.*— The term "parts or accessories" for an automobile truck or other automobile chassis or body, taxable tractor, or motorcycle, includes (a) any article the primary use of which is to improve, repair, replace, or serve as a component part of such vehicle or article, (b) any article designed to be attached to or used in connection with such vehicle or article to add to its utility or ornamentation and (c) any article the primary use of which is in connection with such vehicle or article whether or not essential to its operation or use.
>
> The term "parts and accessories" shall be understood to embrace all such articles as have reached such a stage of manufacture that they are commonly or commercially known as parts and accessories whether or not fitting operations are required in connection with installation. * * *
>
> * * * * *

The seat covers manufactured by taxpayer were parts or accessories under all three subdivisions of Section 316.55. Within the meaning of subdivision (a) the seat covers certainly were intended to, and did "improve" the seats, which are "component" parts of an automobile. It cannot be disputed that the seat covers were articles "designed to be attached to or used in connection with * * * [an automobile] to add to its utility or ornamentation" under subdivision (b). Nor can it be denied that the covers were articles "the primary use of which is in connection with such vehicle * * * whether or not essential to its operation or use" under subdivision (c).

It remains only to be seen whether the definition of parts and accessories contained in the Regulations is reasonable and proper. The Supreme Court has said that it is. A definition of such similar language as to be substantially the same as the present Regulations was conclusively approved by the Court many years ago in *Universal Battery Co.* v. *United States,* 281 U. S. 580. The Court said (pp. 583-584):

> The administrative regulations issued under § 900 [cognate of Section 3403] uniformly have construed the term "part" in that section as meaning any article designed or manufactured for the special purpose of being used as, or to replace, a component part of such vehicle, and which by reason of some characteristic is not such a commercial article as ordinarily would be sold for general use, but is primarily adapted for use as a component part of such vehicle. *The regulations also have construed the term "accessory" as meaning any article designed to be used in connection with such*

vehicle to add to its utility or ornamentation and which is primarily adapted for such use, whether or not essential to the operation of the vehicle.

This construction of those terms has been adhered to in the Internal Revenue Bureau for about ten years and it ought not to be disturbed now unless it be plainly wrong. We think it is not so, but is an admissible construction. * * * *We think the view taken in the administrative regulations is reasonable and should be upheld. It is that articles primarily adapted for use in motor vehicles are to be regarded as parts or accessories of such vehicles,* even though there has been some other use of the articles for which they are not so well adapted. (Italics supplied.)

The instant case speaks even more strongly for a finding that the seat covers were "parts or accessories", for each set was cut and sewed specially to fit a particular automobile, and had no other use. (R. 108.)

Taxpayer has apparently abandoned on appeal his argument that the covers are not embraced under the first paragraph of the regulation defining parts and accessories. His argument (Br. 45-48) is now directed to the second paragraph, which states that all articles which "have reached such a stage of manufacture that they are commonly or commercially known as parts and accessories" shall be so considered "whether or not fitting operations are required in connection with installation". He would have the Court read the second paragraph as restricting the meaning of the first; that, in order to be a part or accessory, an article, in addition to its having been "designed to be attached to or used in connection with * * * [an automobile]

to add to its utility or ornamentation", must have been "commonly or commercially known" as a part or accessory. But the second paragraph was not meant as an additional requirement to be super-imposed on the first. In neither paragraph is it stated or implied that in addition to falling under the terms of the first an article must also be commonly or commercially known as a part or accessory under the second. Rather than to restrict the scope of the first, the real purpose of the second paragraph, as seen from its language, was to prevent the first from being too narrowly construed in the situation where "fitting operations are required in connection with installation".

Even accepting taxpayer's position that to have been parts or accessories the seat covers must have been commonly or commercially known as such, we encounter no difficulty reconciling the District Court's finding with the Regulations. Taxpayer stresses the fact that he testified that the covers might not be recognizable if compared with ready-made covers. (R. 124.) But certainly no distinction can be taken between ready-made and custom-made covers in determining whether they are parts or accessories. There is no requirement that, for an article to be commercially known as a part or accessory, the uninformed layman must be able to recognize it for what it is. It is doubtful that the average layman could identify many of the numerous parts which form the engine or transmission of an automobile. They are nonetheless parts. The test is whether the article is "commercially known" and recognizable in the trade. Taxpayer has offered no evidence that it is not. Moreover, the implications are inescapable, and must lead inevitably to the conclusion that anyone in the business of manufacturing custom-made seat covers would recognize taxpayer's product

before installation. There is no evidence that his method was unique.

The fact that the installation may have required the attention of a skilled and experienced person in no way detracts, as taxpayer suggests it should (Br. 46-47), from the classification of the covers as parts or accessories.

C. *Manufacture or Repair*

1. Definition of Manufacture

There can be little question that the process employed by taxpayer, whereby seat covers were produced in his shop by the application of machinery and skilled labor to raw materials, was manufacturing, and that the final result was a manufactured article. Webster's New International Dictionary, Unabridged (2d ed.), gives this definition of manufacture: "To make (wares or other products) by hand, by machinery, or by other agency * * *. To work, as raw or partly wrought materials, into suitable forms for use". Regulations 46 define a manufacturer as follows:

> SEC. 316.4 *Who is a manufacturer.*—The term "manufacturer" includes a person who produces a taxable article from scrap, salvage, or junk material, as well as from new or raw material, (1) by processing, manipulating, or changing the form of an article, or (2) by combining or assembling two or more articles.
>
> * * * * *

In approving the definition in the above quoted regulation this Court said in *United States* v. *Armature Exchange,* 116 F. 2d 969, 971, certiorari denied, 313 U. S. 573:

> This provision has appeared in the Treasury Regulations since 1920, during which time the stat-

> ute taxing manufacturers and producers of automobile accessories has been reenacted, without change material to this cause, several times. "Under the established rule Congress must be taken to have approved the administrative construction and thereby to have given it the force of law." *Helvering* v. *Reynolds Tobacco Co.,* 306 U. S. 110, 115, 59 S. Ct. 423, 426, 83 L. Ed. 536.

Clearly taxpayer's operation constituted manufacturing within the meaning of the controlling regulation. He owned and kept on hand an inventory of the various materials he used, and all of the cloth for the covers was taken from this inventory. (R. 52, 89.) His method of production was to start with just a plain bolt of material from which he cut pieces which he fashioned according to a pattern so as to fit the dimensions of a particular seat. Then a piece was cut from another material to the same dimensions and sewed to the underside of the covering as a facing. This operation was repeated for the various sections of the cushions and lazybacks. The several pieces were then sewed together and a decorative piping sewed at the seams. This work was done by the taxpayer and his employee in the shop (but not on the seat) by hand and with a sewing machine. The completed cover was then pulled on the seat and attached with tacks or hog rings. (R. 94-96, 111, 119-121.) Surely the District Court was correct in characterizing this process as manufacturing. It was the production of seat covers from plain bolts of cloth "by processing, manipulating, or changing the form of" the cloth as well as "by combining or assembling two or more" pieces of material.

If the operations in *United States* v. *J. Leslie Morris Co.,* 124 F. 2d 371 (C.A. 9th); *Clawson & Bals* v.

Harrison, 108 F. 2d 991 (C.A. 7th), certiorari denied, 309 U. S. 685; and *Clawson & Bals* v. *United States,* 182 F. 2d 402 (C.A. 7th), constituted manufacturing, then taxpayer's operations must also. In each of those cases the taxpayer had acquired old burned-out connecting rods which he reconditioned. In each case it was claimed that the process of reconditioning was in the nature of repair, not manufacture, because no transformation of product was attained. The process started and ended with connecting rods. The same argument was advanced in *United States* v. *Armature Exchange,* 116 F. 2d 969 (C.A. 9th), certiorari denied, 313 U. S. 573, and *United States* v. *Armature Rewinding Co.,* 124 F. 2d 589 (C.A. 8th), where worn-out armatures were reconditioned. Nevertheless, in each case it was held to be a manufacturing process. This Court reasoned in the *Armature Exchange* case (p. 971) that the worn-out article, since it no longer had any use as an armature, bore the same relation to the reconditioned article as raw material does to any manufactured article.

The instant case provides a much simpler and clear-cut illustration of manufacturing, for the process ended with an entirely different article from the plain strips of cloth which went into the making. Taxpayer began with plain rolls of material, which he transformed to finished seat covers by the application of skill and machinery. The material was cut to dimensions, sewed to other such sections, and finished with a piping around the edges. While the procedure may not have been difficult, complexity is not the mark of manufacturing. The conclusion of the District Court (R. 58) that "seat covers were in fact manufactured, for the cars came out of the shop with seat covers where there were none

in the shop when the cars were driven in", is persuasive.

2. Taxpayer Was the Manufacturer

It is at once apparent that, if seat covers were manufactured, someone must have manufactured them. Taxpayer contends that he was a repair man, and did no manufacturing. That would leave the purchaser of the seat cover as the only possible manufacturer. The District Court correctly ruled, however (R. 58-59), that the purchaser is not the manufacturer unless he brings in his own material to be worked on. In such a case, where he retains title to the article, it might be said that he has merely hired a workman to perform services, and, as employer, is the manufacturer himself. "On the other hand," said the District Court (R. 58-59), "where the jobber supplies the material as well as his skill and labor and the customer pays for the seat covers at a price for completed and installed seat covers, the jobber is the manufacturer and is liable for the tax". That the ownership of the article being worked on is important in determining who the manufacturer is, was recognized by this Court in *United States* v. *J. Leslie Morris Co.,* 124 F. 2d 371, 372, and by the Seventh Circuit in *Clawson & Bals* v. *Harrison,* 108 F. 2d 991, 993, certiorari denied, 309 U. S. 685. Regulations 46 also recognize that only where the purchaser is the owner of the material being worked upon will he be considered the manufacturer, and the workman a repairer.[4]

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[4] Sec. 316.4 * * *

Under certain circumstances, as where a person manufactures or produces a taxable article for a person who furnishes materials and retains title thereto, the person for whom the taxable article is manufactured or produced, and not the person who actually manufactures or produces it, will be considered the manufacturer.

Taxpayer's insistence that he was merely a repair man seems to be founded on his view that the seats were being repaired. (Br. 35.) He would have the Court disregard the fact that his operations were aimed at producing, and did produce seat covers. He sold these covers at several price levels depending upon the grade of material. (R. 104.) The price reflected not only the cost of the raw material, but the cost of labor for measuring, cutting, and sewing the material. (R. 122-123.) The cost of installation was eliminated from the price, in accordance with Section 3441 of the Code (Appendix, infra) in arriving at the taxable basis. (R. 26, 45.) In any event it is stipulated that the amount of the assessment is proper if the seat covers are automobile accessories and were manufactured or produced as contemplated by Section 3403 of the Code. (R. 48, 51.) This is not a case where the owner of an automobile wants a rip or tear in his car seat mended, and contracts merely for labor and services.[5] In such a case he owns the seat, and the workman could be classified a repairer. See *Clawson & Bals* v. *Harrison, supra,* p. 993. In the instant case the seats were not being worked upon at all. Of course the seats were the incidental object for which the covers were being manufactured. But the fact that the covers were to aug-

[5] Taxpayer usually repaired tears in the factory seat covers if there were any (R. 114), but never charged for this work because the dealers were such good customers (R. 110). On occasion he replaced broken springs with new ones (R. 95), and did any necessary welding (R. 104). But extra charges were assessed the customers for such items. (R. 104, 109.) It is seen that the price for the seat covers did not reflect any of these incidental repairs. The price included only the cost of the labor and material used in making and installing the covers, plus a profit margin. (R. 109, 122-123.)

ment and improve the seats does not mean that taxpayer was a repairer of seats instead of a manufacturer of seat covers. If the test of a repairer were, as taxpayer suggests, whether the article was made to augment or recondition another article, no automobile parts and accessories could be taxed to the manufacturer, for the primary feature of all such parts and accessories is that they are made with the ultimate objective of reconditioning or repairing the component parts of an automobile.

Taxpayer is attempting to divert the issue from whether he was manufacturing seat covers to whether the seats were repaired by the installation of the covers. But, as we pointed out above, the installation feature of taxpayer's work is no part of this case. The Government has not taxed his charges for installation. (R. 26.) The basis for the tax is the sales receipts attributable to the price charged for the seat covers only, before installation. The Code so requires. Section 3441. The District Court adequately answered taxpayer's argument that the question is whether he repaired the seats by installing the covers (R. 59):

> * * * the word "repair" in this context must have reference to the particular part or accessory in question. Thus since we are dealing with seat covers and not seats, the repairing must have reference to seat covers and not seats. In other words, plaintiff must claim that the seat covers are being repaired. A seat cover is repaired only if a portion of it is redone and the basic seat cover is still intact.

The question is, did taxpayer manufacture covers, so that he was subject to the tax, or did he merely repair

existing covers? To ask the question is to give the answer. It is beyond any possible dispute that no covers were in existence at the commencement of each job. Taxpayer started each job with plain rolls of material. His operations were not directed at repairing the material; they were aimed at transforming the material through the application of skill and experience, into finished seat covers. Taxpayer cannot hope to contend that this was not a manufacturing process, and that he was not the manufacturer.

Taxpayer argues (Br. 30-31) that seat covers are manufactured articles only where they are "produced and kept in stock for sale to the general market"; that inasmuch as his covers were "custom made", he cannot be considered a manufacturer. But Section 3403 makes no distinction between articles made to order and articles made for stock. The inquiry is, did he or did he not make the covers? There is a basic inconsistency in his argument that because he custom made the covers he did not make them at all. That he made them to order does not change the fact that his operations were manufacturing operations.

The case of *John J. Roche Co.* v. *Eaton,* 14 F. 2d 857, decided in 1926 by the District Court for the District of Connecticut, is distinguishable on its facts. There the tax was assessed on taxpayer's receipts from much more extensive operations than making seat covers. The company fitted side curtains, tops, seat covers, carpets, and generally reupholstered cars. Furthermore, it repaired automobile bodies and fenders. No attempt was made to segregate the repairs from the manufacture. Instead, the tax was assessed on the receipts from all the above items. Concededly much of the work done was in the nature of repair, so much so

that the court was able to say (p. 858) that "the dominant aspect of the transactions engaged in by the plaintiff was that of work performed." The District Court in the instant case said of the *Roche* case (R. 59) that it "seems to have overlooked the question of who is the manufacturer".

D. *Taxpayer's alleged distinction between sales and contracts for work, labor and material*

Taxpayer has made an elaborate argument. Br. 49-58) in an attempt to prove that the seat covers he produced were made under contracts for work, labor, and material, rather than contracts of sale within the meaning of the Uniform Sales Act. The clear language of Section 5 of that Act that "goods which form the subject of a contract to sell may be * * * goods to be manufactured * * * by the seller after the making of the contract to sell" is to the contrary. But, in any event, the meaning of Congress in enacting Section 3403 of the Internal Revenue Code is here in question, not the Uniform Sales Act or any other statute. Congress intended to impose the tax upon goods manufactured when title passed to a purchaser (Treasury Regulations 46, Sec. 316.5) and this precisely describes what transpired here. With respect to taxpayer's contentions, the following may also be taken into consideration:

First: A contract for work, labor, and material is not the equivalent of a contract to repair; it is just as consistent to find that it is a contract to manufacture. We need look no further than the case relied upon by taxpayer to illustrate this. In *Crystal Rec.* v. *Seattle Assn. Etc.*, 34 Wash. 2d 553, 558, 209 P. 2d 358, 361, the court said:

> In order to resolve this question [where title was], we must first determine whether the agreement was a *contract for the sale* of goods to be manufactured *or a contract for the manufacture of goods.* If it be held the former, then the various provisions of the uniform sales act will apply in construing this contract. *If it be held the latter, then it is in the nature of the common-law contract for work, labor, and materials,* * * *. [Italics supplied.]

It is plain that the court considered "a contract for the manufacture of goods" to be "in the nature of the common-law contract for work, labor, and materials". The basic question whether taxpayer was a manufacturer or a repairer is not answered by resort to the common law of sales or the Uniform Sales Act. Nor is it answered by asserting that the contract was for work, labor, and material.

Second: Even considering the Uniform Sales Act as having some remote bearing on whether taxpayer manufactured and sold seat covers within the meaning of the Internal Revenue Code, taxpayer has failed to recognize the basic distinction between a contract to sell and a sale. The Sales Act definition of a sale is in Section 1 (2) of the Uniform Act: "A sale of goods is an agreement whereby the seller transfers the property in goods to the buyer for a consideration called the price." Taxpayer urges that since there were no contracts to sell (he contends they were contracts for work, labor, and material), there were no sales. It may be, although we do not concede, that there were no contracts to sell, within the meaning of the Sales Act, but when the covers were completed, their transfers to the purchasers could be nothing else than actual sales under Section 1 (2).

Third: The cases cited by taxpayer were sales cases in which it was important to distinguish contracts for work, labor, and material from contracts to sell. If the case could be construed as a contract to sell it would fall under the mantle of the Sales Act which established statutory tests for determining where title was, and provided certain statutory remedies not available under the common law. It also gave rise to implied warranties of merchantability and fitness for purpose, not present at common law. But to repeat, those cases do not mean that where goods are manufactured and title transferred to the purchaser under a contract, there has been no actual sale merely because the contract was for work, labor, and material rather than a contract to sell.

We do not think there can be any serious question as to whether seat covers were sold by the taxpayer to his customers. If it is important to look to the intention of the parties to determine whether the price represented the charge for seat covers rather than a charge for services, then the evidence shows these were sales of goods, not the price for services performed. Taxpayer had flat charges of $18, $28, and $35 *for the covers;* the price depended only on the material used. (R. 104, 109.) There is no indication that the customers were charged varying rates depending on the labor time and difficulty of the job.

Fourth: It is familiar law that taxes are a practical matter, and the Code should be construed consistently with common understanding of words in order to stress substance over form. It seems fair to say that seat covers were sold by taxpayer within the meaning of Section 3403 of the Code regardless of technical restric-

tions placed on the word "sale" in the Uniform Sales Act.

The state court decisions cited by taxpayer (Br. 56) as applying the distinction between a contract for work, labor, and materials and a contract to sell are to be distinguished. In *Samper* v. *Indiana Dept. of State Revenue,* 231 Ind. 26, 106 N.E. 2d 797, the taxpayer admittedly was in the business of repairing radios. The Indiana Code taxed receipts from repairs at a higher rate than receipts from sales of tangible personal property. The taxpayer claimed that the portion of his receipts from repairs, attributable to the cost of tubes and other material he used to repair radios, should be taxed as sales, not repairs. It was held that this amount was taxable as repairs. The important distinction, recognized in *Clawson & Bals* v. *Harrison,* 108 F. 2d 991, 993 (C.A. 7th), certiorari denied, 309 U. S. 685, and *United States* v. *J. Leslie Morris Co.,* 124 F. 2d 371, (C.A. 9th), is that the radios remained the property of the persons for whom the repairs were performed. The same may be said of *Singing River Tire Shop* v. *Stone,* 21 S. 2d 580 (Miss.), where the taxpayer vulcanized and recapped tires, but the tires belonged to the persons for whom the work was done. The tax in *Gross Income Tax Div.* v. *Conkey Co.,* 228 Ind. 352, 90 N.E. 2d 805, was applicable to gross income from whatever source, the question being whether the tax, as applied, was an invalid interference with and burden on interstate commerce. The case should be read in the light that state courts will go far in attempting to solve their local revenue problems. The court upheld the validity of the tax on a printer of books, holding that he was not selling goods in interstate commerce, but had merely entered into local contracts

for work, labor, and material. Compare *Dept. of Treasury* v. *Mfg. Co.,* 313 U.S. 252, where a similar tax statute was upheld against the same objection. However, the article on which the taxpayer worked was owned by the party for whom the work was performed; so clearly, the receipts were for services, not from sales.

In the final analysis it seems to us that this argument of taxpayer, that his contracts were for work, labor, and material under the law of sales, is merely another way of stating his contention that he was a repairer, not a manufacturer. That is the ultimate point of which he wishes to persuade this Court. We have fully discussed our view that he was a manufacturer.

E. *The rulings*

1. The Government Has Not Reversed Its Position as to the Taxability of Taxpayer's Sales

Taxpayer argues (Br. 16-28) that the Internal Revenue Bureau changed its position as to the taxability of sales of automobile seat covers, and that he, the taxpayer, has been injured because of his reliance on the rulings in effect during the tax years. The fact is that the Bureau has consistently maintained that sales such as taxpayer's are taxable under Section 3403. In its ruling of August 18, 1952 (S. T. 944, 1952-2 Cum. Bull. 255 (Appendix, infra)) the Bureau pointed out that it had—

> issued rulings * * * that sales by a manufacturer of seat covers, produced according to individual design and measurements, to a dealer in new or used cars are not considered sales for consumption, and are subject to tax. The taxability of such sales is

not affected by the ruling herein, and tax continues to attach, as in the past, to such sales. [6]

This ruling reiterated the Bureau's position that sales to dealers were taxable.

Taxpayer argues that inasmuch as there were no public rulings on seat covers, he was entitled to rely on rulings relating to other parts and accessories taxable under Section 3403. (See Br. 19-21.) But each of the rulings to which he refers deals with repair jobs. If, as we contend, the taxpayer was a manufacturer, not a repairer, those rulings are inapposite here. Moreover, the final answer to this argument is that he did not rely on these, or any other rulings.

It is clear from his testimony (R. 106) that he knew nothing about excise taxes. It is apparent that before June of 1952, he was not even aware that there was a manufacturer's excise tax. (R. 104-106.) If taxpayer is trying to raise an estoppel, he must surely show actual reliance. It is not enough that he might have relied on prior rulings had he been aware of them. It is no answer (Br. 26) that he did not collect the taxes from his customers, and will thus have to bear the burden himself. Section 3403 placed the liability for the tax on him.

2. Legal Effect of Rulings

We have shown above that the Bureau has consistently applied the manufacturer's excise tax to operations such as that of taxpayer. However, even if there

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[6] The purpose of this ruling was to announce that, after the effective date, sales of custom-made seat covers by the manufacturer to the consumer were to be taxed as well as such sales to dealers. Prior to the ruling sales to dealers were taxed while sales to individual owners of automobiles were not taxed. This disinction was discarded by the ruling.

were inconsistencies in the application of the tax, that would be no reason to set aside the assessment. Regulations and rulings are not binding on the Bureau if wrong. *Goldfield Consol. Mines* v. *Scott,* 247 U.S. 126. The Commissioner has the power to reverse the position he took in prior rulings even where such action might retroactively affect a taxpayer adversely. In *Tonningsen* v. *Commissioner,* 61 F. 2d 199 (C. A. 9th), the argument was advanced that the effective ruling during the tax year in question allowed a certain deduction, whereas a ruling issued subsequently was being applied retroactively so as to deny the deduction. This Court held (pp. 199-200):

> The argument advanced as to the applicability of I. T. 1171 [the prior ruling] to the tax return in question is answered adversely to petitioners by the settled rule that the Commissioner is not precluded by a previous determination from re-examination and redetermination of tax liability.

The recent decision of the Sixth Circuit in *Automobile Club of Mich.* v. *Commissioner,* 230 F. 2d 585, is in point. There, with reference to a revocation of a ruling the court pointed out (p. 589) that "The Commissioner is not bound by his own or his predecessor's prior mistakes of law". See *Wilbur Nat. Bank* v. *United States,* 294 U. S. 120, 123-124; *Chiquita Mining Co.* v. *Commissioner,* 148 F. 2d 306 (C. A. 9th).

Under the above principles, *Johnnie & Mack, Inc.* v. United States, 123 F. Supp, 400 (S. D. Fla.), was wrongly decided. It may be that under the rulings prior to August 18, 1952, manufacturers of seat covers who sold directly to consumers were not taxed under Section 3403. But this is no justification for holding

that those who sold to dealers should thereby be relieved. Sales to dealers were always taxable under the rulings. The court in *Johnnie & Mack* apparently felt that since the distinction in the rulings between sales to individuals and to dealers was unwarranted, sales to neither were to be taxed. That there may have been an invalid distinction in the old rulings affords no basis for holding neither group taxable. Inasmuch as the Commissioner can, with retroactive effect, remedy prior incorrect rulings *(Tonningsen* v. *Commissioner, supra)* certainly correct rulings should not be disregarded for the sake of achieving uniformity of treatment. "The proper view to take", said the court below (R. 56), "where there is no warranted distinction between sales to individuals and sales to dealers is to hold all such sales taxable regardless of the type of buyer".

CONCLUSION

For the reasons given above the judgment of the District Court was correct and should be affirmed.

Respectfully submitted,

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May, 1956.

APPENDIX

Internal Revenue Code of 1939:

SEC. 3403.[7] TAX ON AUTOMOBILES, ETC.

There shall be imposed upon the following articles sold by the manufacturer, producer, or importer, a tax equivalent to the following percentages of the price for which so sold:

(a) [as amended by Sec. 544(a) of the Revenue Act of 1941, c. 412, 55 Stat. 687, and Sec. 481(a) of the Revenue Act of 1951, c. 521, 65 Stat. 452] Automobile truck chassis, automobile truck bodies, automobile bus chassis, automobile bus bodies, truck and bus trailer and semitrailer chassis, truck and bus trailer and semitrailer bodies, tractors of the kind chiefly used for highway transportation in combination with a trailer or semitrailer (including in each of the above cases parts or accessories therefor sold on or in connection therewith or with the sale thereof), 8 per centum, except that on and after April 1, 1954, the rate shall be 5 per centum. A sale of an automobile truck, bus, or truck or bus trailer or semitrailer, shall, for the purposes of this subsection, be considered to be a sale of the chassis and of the body.

(b) [as amended by Sec. 481 (b) of the Revenue Act of 1951, *supra*] *Other Chassis and Bodies, Etc.* —Other automobile chassis and bodies, chassis and bodies for trailers and semitrailers (other than house trailers) suitable for use in connection with passenger automobiles, and motorcycles (including in each case parts or accessories therefor sold on or in connection therewith or with the sale thereof),

[7] None of the amendments to Section 3403 are relevant to the issues here involved and the language of the section may be regarded as substantially the same during the entire period in question.

except tractors, 10 per centum, except that on and after April 1, 1954, the rate shall be 7 per centum. A sale of an automobile, trailer, or semitrailer shall, for the purposes of this subsection, be considered to be a sale of the chassis and of the body.

(c) [as amended by Sec. 544 (b) of the Revenue Act of 1941, *supra;* Sec. 605(c)(1) of the Revenue Act of 1950, c. 994, 64 Stat. 906; and Sec. 481 (c) of the Revenue Act of 1951, *supra*] Parts or accessories (other than tires and inner tubes and other than radio and television receiving sets) for any of the articles enumerated in subsection (a) or (b), 8 per centum, except that on and after April 1, 1954, the rate shall be 5 per centum. * * *

* * * * *

(26 U.S.C. 1952 ed., Sec. 3403.)

SEC. 3441. SALE PRICE.

(a) In determining, for the purposes of this chapter, the price for which an article is sold, there shall be included any charge for coverings and containers of whatever nature, and any charge incident to placing the article in condition packed ready for shipment, but there shall be excluded the amount of tax imposed by this chapter, whether or not stated as a separate charge. A transportation, delivery, insurance, installation, or other charge (not required by the foregoing sentence to be included) shall be excluded from the price only if the amount thereof is established to the satisfaction of the Commissioner, in accordance with the regulations.

* * * * *

(26 U.S.C. 1952 ed., Sec. 3441.)

Treasury Regulations 46 (1940 ed.), promulgated under the Internal Revenue Code of 1939:

SEC. 316.4 *Who is a manufacturer.*—The term "manufacturer" includes a person who produces a taxable article from scrap, salvage, or junk material, as well as from new or raw material, (1) by processing, manipulating, or changing the form of an article, or (2) by combining or assembling two or more articles.

Under certain circumstances, as where a person manufactures or produces a taxable article for a person who furnishes materials and retains title thereto, the person for whom the taxable article is manufactured or produced, and not the person who actually manufactures or produces it, will be considered the manufacturer.

A manufacturer who sells a taxable article in a knockdown condition, but complete as to all component parts, is liable for the tax, and not the person who buys, and assembles a taxable article from, such component parts.

SEC. 316.55 *Definition of parts or accessories.*—The term "parts or accessories" for an automobile truck or other automobile chassis or body, taxable tractor, or motorcycle, includes (a) any article the primary use of which is to improve, repair, replace, or serve as a component part of such vehicle or article, (b) any article designed to be attached to or used in connection with such vehicle or article to add to its utility or ornamentation, and (c) any article the primary use of which is in connection with such vehicle or article whether or not essential to its operation or use.

The term "parts and accessories" shall be understood to embrace all such articles as have reached such a stage of manufacture that they are com-

monly or commercially known as parts and accessories whether or not fitting operations are required in connection with installation. The term shall not be understood to embrace raw materials used in the manufacture of such articles.

Spark plugs, storage batteries, leaf springs, coils, timers, and tire chains, which are suitable for use on or in connection with, or as component parts of, automobile truck or other automobile chassis, taxable tractors, or motorcycles, are considered parts of or accessories for such articles whether or not primarily designed or adapted for such use.

S. T. 944, 1952-2 Cum. Bull. 255:

Section 3403 (c) of the Code, as amended, imposes, effective November 1, 1951, a tax of 8 percent on the sale by the manufacturer of parts or accessories for vehicles taxable under subsection (a) and (b) of section 3403 of the Code, as amended, except that on and after April 1, 1954, the rate of tax shall be 5 percent. Seat covers for automobiles are considered to be parts or accessories within the meaning of section 3403 (c) of the Code, as amended, and sales thereof by the manufacturer are subject to tax.

The Bureau has issued rulings heretofore that the only circumstances under which the tax does not apply to sales of seat covers by a manufacturer, is where the seat covers are individually designed, cut, tailored, and fitted by the manufacturer to the automobile belonging to the person who contracts for the performance of such operation, and such person is the consumer of the seat covers. Such rulings provided, however, that the sale of seat covers, similarly produced, to a dealer in new or used automobiles is not a sale for consumption but

one for resale, and that the tax attaches to the manufacturer's sale thereof.

Upon reconsideration of the matter, the Bureau is now of the opinion that where a manufacturer furnishes the material and produces automobile seat covers for the consumer thereof, according to individual design and measurement, the sale by the manufacturer of such seat covers is taxable under section 3403(c) of the Code, as amended, regardless of whether they are installed by the manufacturer or by other persons.

The Bureau has issued rulings, as stated above, that sales by a manufacturer of seat covers, produced according to individual design and measurements, to a dealer in new or used cars are not considered sales for consumption, and are subject to tax. The taxability of such sales is not affected by the ruling herein, and tax continues to attach, as in the past, to such sales.

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